ARAB-MALAYSIAN MERCHANT BANK BHD

v.

ORIENT APPAREL BHD

HIGH COURT MALAYA, IPOH
JAMES FOONG J
[COMPANIES WINDING-UP NO: 28-60-1998]
11 SEPTEMBER 2001

COMPANY LAW: *Winding up - Undue preference - Whether payments to creditor bank caught by provisions of Bankruptcy Act 1967 and Companies Act 1965 - Determination of date of transaction - Common law and statutory rights of set-off*

After the respondent ('OAB') went into liquidation, the liquidator (the applicant in this application) took control and discovered that certain dispositions by OAB to the creditor bank ('the bank') might be void during the relevant periods under s. 293 of the Companies Act 1965 read with s. 53(1) of the Bankruptcy Act 1967 and s. 223 of the Companies Act 1965.

The liquidator filed this application seeking the court for declarations that certain fixed deposits and debit advices paid to the bank during the applicable periods constitute undue preference.

Held:

[1] The fixed deposits were taken more than six months prior to the presentation of the winding-up petition but were uplifted within the said six months. The uplifting of a fixed deposit was not an independent act but an integral part of the transaction which commenced with the pledging of the fixed deposit as collateral with the bank. Consequently, the date for the uplifting of the fixed deposits could not be accepted as the date of the transaction since the transaction had already occurred. (see p 580 a-d)

[2] The liquidator also opposed the argument that the bank has a *lien* over the fixed deposits since the right of a *lien* over the fixed deposits was extinguished by the bank's failure to register them as charges under s. 108(3)(k) of the Companies Act 1965. The fixed deposits were only evidence of acceptance of deposits of one Seow Chee Hong by the bank. It was only when they were used as securities that they fell within the category of "a charge on the credit balance of the company in any deposit account" as described in s. 108(3)(k). Thus, standing by itself, the fixed deposits were not caught under s. 108(3)(k) but the pledging of them were.

However, since the bank had failed to register them as charges at the point of pledge, the bank's common right of set off could not be maintained. (see p 581 c-e)

[3] The bank was not entitled to its statutory right of set-off under s. 41 of the Bankruptcy Act 1967, as that section did not apply in a situation where s. 293 of the Companies Act 1965 read with s. 53(1) of the Bankruptcy Act 1967 operated. (see p 582 a-b; p 583 b-c)

[4] Even if the charge instruments are not registered under s. 108(3)(k) of the Companies Act 1965 and the right of set-off (both the common law and statutory type) is not available to the bank they are void against the liquidator only at the time the liquidator is appointed. In this case, when the liquidator was appointed the fixed deposits had all been up-lifted leaving the liquidator no opportunity to lay his hands on them. (see p 583 c-g)

[5] For the debit advices, since those dispositions were after the presentation of the winding-up petition, s. 223 of the Companies Act 1965 applied. (see p 584 c-d)

[6] It must be accepted that all commercial decisions come with risk and when outcome do not match the forecast, as was the case here, the bank cannot be taken to task for the decision it made when such decision was not dishonest nor reckless. The bank had rebutted the presumption that those dispositions were void under s. 223 of the Companies Act 1965. (see p 585 g-i)

[7] The liquidity problem faced by OAB was projected as temporary. The reports indicated that OAB had a viable core business. The entire purpose of the operation was to sustain the business activity of OAB at that relevant time. The debit advice transacted during this period did not have the effect, as well as, the purpose of giving undue preference to the bank. They were a normal financial business transaction to cater for a company engaged in international trade. (see p 587 c-d; p 588 e-f)

[Application dismissed.]

Case(s) referred to:

Airservices Australia v. Ferrier 21 ACSR 1 ***(refd)***

Bah Heng Hong v. The Provisional Liquidator [1992] 3 CLJ 1421; [1992] 2 CLJ (Rep) 150 ***(refd)***

Bensa Sdn Bhd v. Malayan Banking Bhd [1993] 2 CLJ 68 ***(foll)***

Hamilton v. National Australia Bank Ltd [1991] 5 ACSR 432 ***(refd)***

Hollicourt (Contracts) Ltd v. Bank of Iceland [2001] 1 All ER 281 ***(refd)***

Lian Keow Sdn Bhd v. Overseas Credit Finance (M) Sdn Bhd [1982] 2 MLJ 449 ***(refd)***

Ng Wei Teck v. OCBC Ltd [1998] 2 SLR 1 ***(refd)***
Pekan Nanas Industries Sdn Bhd v. Chang Ching Chuan & Ors [1998] 1 CLJ 793 ***(refd)***
Re Clifton Place Garage Ltd [1970] 1 All ER 353 ***(refd)***
Re Gray Inns Construction Co Ltd (1980) ***(refd)***
Sandell v. Porter [1966] 115 CLR 666 ***(refd)***
Sime Diamond Leasing (M) Sdn Bhd v. Precision Moulding Industries Sdn Bhd [1998] 4 CLJ 557 ***(refd)***
Tan Ah Chim & Sons Sdn Bhd v. Ooi Bee Tat & Anor [1993] 4 CLJ 476 ***(refd)***

Legislation referred to:
Bankruptcy Act 1967, ss. 41, 53(1)
Companies Act 1965, ss. 20, 108(1), (3)(k), 223, 293

For the applicant - Prakash Menon (Steven Puung); M/s Isharidah, Ho, Cheng & Menon
For the respondent - Christopher Leong (TS Lim); M/s Chooi & Co

Reported by Yow Ting Fong

JUDGMENT

James Foong J:

Introduction

Oriental Apparel Bhd (OAB), a public registered company involved in the manufacturing and export of goods, was wound-up on 6 December 1998 by a creditor's petition presented on 4 August 1998.

OAB was a customer of Hong Leong Bank Bhd. (the bank). Since May 1995, the bank had provided trade credit facilities to OAB totaling RM51,700,000. These facilities were granted by the bank pursuant to several letters of offer made to OAB between 1995 to 1997. Disbursements of these facilities and repayment thereto were through a current account maintained and operated by OAB with the bank. These facilities were initially secured:

(a) by the deposit of 3rd party fixed deposit receipts (FD) held in the name of one Seow Chee Hoong;

(b) a joint and several guarantee by Seow Chee Hoong and one Chen Mee Mee in favour of the bank;

(c) a deed of assignment and a power of attorney in favour of the bank of landed property known as Lot RKA 8 & 9 Bandar Baru Kundang, Rawang;

(d) the setting up of a sinking fund where 5% of the proceeds of each export/ trade bill of OAB would be deducted and placed in FD as security.

Sometime in February 1998 the bank discovered that majority of OAB's trade bills discounted in pursuant to the credit facilities it offered to OAB were in respect of one company in Hong Kong known as Monchique Holdings Ltd (Monchique). Monchique had only a paid up capital of HK1,000. To safeguard its exposure, the bank obtained from OAB further securities. These were:

(a) a loan agreement between OAB and the bank dated 10 April 1998;

(b) a debenture dated 10 April 1998 which creates a first fixed and floating charge over the assets of OAB;

(c) an account assignment dated 10 April 1998 in respect of FD held by OAB with the bank;

(d) a supplementary loan agreement between OAB and the bank dated 4 May 1998.

Due to liquidity problem encountered by OAB, in April/May 1998 Arthur Anderson was appointed as financial consultants to the company. It undertook to review and prepare a debt-restructuring scheme for OAB. From this exercise, Arthur Anderson prepared two reports dated 23 June 1998 and 21 July 1998 respectively. These reports were distributed to OAB creditors including the bank.

According to the bank, a meeting was held between them, Arthur Anderson and OAB. At this meeting, Arthur Anderson announced that OAB's business was still viable for the next one year. To support OAB, the bank continued to make available the credit facilities to OAB in order for the company to carry on with its business. To further protect itself, additional securities were obtained from OAB. These were:

(a) a letter of assignment dated 18 June 1998 whereby OAB agreed to channel all export bills and proceeds therefrom to the bank;

(b) a second supplementary loan agreement between OAB and the bank dated 1 October 1998.

The Liquidator's Claim

After OAB went into liquidation, the liquidator (the applicant in this application) took control of its affairs. He discovered that certain dispositions by OAB to the bank might be void under s. 293 of the Companies Act read with s. 53(1) of the Bankruptcy Act and, s. 223 of the Companies Act. To remedy this, he has filed this application (encl. 110) seeking from this court the following:

(1) A declaration that all properties of OAB pledged as security for trade credit facilities granted by the bank to OAB constitute undue preference and should be returned to the liquidator.

(2) A declaration that all monies withdrawn and paid out to the bank between 4 February 1998 to 6 December 1998 under the current account operated by OAB with the bank constitute undue preference.

(3) A declaration that all monies credited to the current account of OAB with the bank between 4 August 1998 and 6 December 1998 constitute undue preference and are therefore void.

(4) Alternatively, all monies debited to the account of OAB with the bank between 4 August 1998 and 6 December 1998 constitute undue preference and are void.

(5) The bank to account for all monies handled by them under prayer (2), (3) and (4) above and thereafter be returned to the liquidator.

The Bank's Stand

The bank denies that the dispositions mentioned are void and insists that the bank is not liable to account and return any monies to the liquidator.

Issues

Based on the contentions above, the issue in this case is: whether the dispositions made by OAB in favour of the bank are preferential payment rendering them void under s. 293 of the Companies Act to be read with s. 53(1) of the Bankruptcy Act, and under s. 223 of the Companies Act.

Subject Matters In Contention

Realising that the transactions between the bank and OAB, within the time span in question, cover a wide range of matters, Mr. Prakash, counsel for the liquidator, in his submission has confined the liquidator's claim to only the following dispositions:

(a) Loan repayments by OAB to the bank from FD belonging to Seow Chee Hong.

(b) Loan repayment by OAB to the bank through debit advice.

(c) Bank charges on Trade Bills and Overdraft (OD) facilities granted by the bank to OAB.

(d) Execution of security documents by OAB or 3rd party in favour of the bank.

Particulars Of Subject Matters In Contention

For consideration of this case, it is necessary to set out the particulars of each subject matter under contention.

(a) FD

1. There is a sum of RM18,688,647.57 in various FD deposited by Seow Chee Hoong with the bank before 4 February 1998 which were subsequently up-lifted by the bank in April 1998 to repay the credit facilities extended to OAB by the bank.

2. A sum of RM55,887.92 in several FD deposited by Seow Chee Hoong with the bank after 4.2.1998 which were also up-lifted by the bank in April 1998 to repay credit facilities extended to OAB by the bank.

(b) Debit Advice

1. A sum of RM8,627,507.93 was taken from OAB's account by the bank to repay towards credit facilities utilised by the OAB between 5 August 1998 to 6 December 1998.

2. A sum of RM20,018,429.30 was taken from OAB's account by the bank to repay towards credit facilities utilised by OAB between 4 February 1998 to 4 August 1998 (the 'twilight period').

(c) Trade Bills & OD charges

1. A sum of RM49,537.99 and RM9,299.41 respectively levied by the bank as charges on Trade Bills and OD utilised by OAB between 5 August 1998 and 6 December 1998.

2. A sum of RM139,849.85 and RM1,695.56 respectively levied by the bank on Trade Bills and OD utilised by OAB between 4 February 1998 and 4 August 1998 (the twilight period).

(d) Security Documents

1. Execution of a loan agreement dated 10 April 1998 for facilities extended to OAB by the bank.

2. Creation of a debenture for a first legal and floating charge over assets of OAB in favour of the bank on 10 April 1998 (within the twilight period).

3. Execution by OAB of an account assignment dated 10 April 1998 in favour of the bank (within the twilight period).

4. Execution of a supplementary loan agreement OAB in favour of the bank on 4 May 1998 (within the twilight period).

5. Execution by OAB of a letter of assignment dated 18 June 1998 (within the twilight period) in favour of the bank to channel all export bills and proceeds of OAB to the bank.

6. Execution by OAB of a second supplementary loan agreement dated 1 October 1998 in favour of the bank.

The Applicable Law

For determination of the issues in this case, the pertinent laws are s. 223 of the Companies Act, and s. 293 of the Companies Act to be read with s. 53(1) of the Bankruptcy Act. These are set out below:

Section 223 of the Companies Act states:

> Avoidance of dispositions of property, etc
>
> Any disposition of the property of the company including things in action and any transfer of shares or alteration in the status of the members of the company made after the commencement of the winding up by the Court shall unless the Court otherwise orders be void.

And s. 293 of the Companies Act provides:

> Undue preference
>
> (1) Any transfer, mortgage, delivery of goods, payment, execution or other act relating to property made or done by or against a company which, had been made or done by or against an individual, would in his bankruptcy under the law of bankruptcy be void or voidable shall in the event of the company being wound up be void or voidable in the like manner.
>
> (2) For the purposes of this section the date which corresponds with the date of presentation of the bankruptcy petition in the case of an individual shall be -
>
> (a) in the case of winding up by the Court -
>
> (i) the date of presentation of the petition.

Then s. 53(1) of the Bankruptcy Act declares:

Avoidance of preference in certain cases

(1) Every conveyance or transfer of property or charge thereon made, every payment made, every obligation incurred and every judicial proceeding taken or suffered by any person unable to pay his debts, as they become due, from his own money in favour of any creditor or any person in trust for any creditor shall be deemed to have given such creditor a preference over other creditors if the person making, taking, paying or suffering the same is adjudged bankrupt on a bankruptcy petition presented within six months after the date of making, taking, paying or suffering the same and every such act shall be deemed fraudulent and void as against the Official Assignee.

Undeniably, the objective of these provisions is to prevent a creditor from obtaining for himself an unfair advantage at the expense of other creditors by concluding transactions during these periods.

Applicable Period

By the nature of the laws to be applied there are two important periods to bear in mind:

1. Between 5 August 1998 (a day after the filing of the winding-up petition) and 6 December 1998 (the date of the winding up). For this period the provision in s. 223 of the Companies Act shall apply. For ease of reference, I shall refer to this period as "the period under s. 223".

2. Between 4 February 1998 (six months from the date of presentation of winding up petition) and 4 August 1998 (the date of the filing of the winding up petition). For this period the law as laid down in s. 293 of the Companies Act read with s. 53(1) of the Bankruptcy Act shall apply. This stretch of time is commonly known as the 'twilight period' for the simple reason that one is uncertain whether the company will be wound up or continued to function. Again for ease of reference, I shall use this term to refer to this time frame.

Analysis

I shall deal with each of the items in contention separately beginning with:

(a) FD

1. The Sum Of RM18,688,647.57

These FD were all taken before the twilight period but uplifted in April 1998 (during the twilight period). Since they were created outside the period in question, the bank contends that these are not liable for consideration under s. 293 of the Companies Act to be read with s. 53(1) of the Bankruptcy Act.

The liquidator disagrees and insists that the period of transaction must be the time when these FD were uplifted. For support the liquidator cited: *Bah Heng Hong v. The Provisional Liquidator* [1992] 3 CLJ 1421; [1992] 2 CLJ (Rep) 150, *Bensa Sdn Bhd v. Malayan Banking Bhd* [1993] 2 CLJ 68 and *Lian Keow Sdn Bhd v. Overseas Credit Finance (M) Sdn Bhd* [1982] 2 MLJ 449.

Of these three cases, my view is that the principle stated in *Bensa* is most appropriate for application to the present circumstances. This is for reason that, similar to the facts of the present case, FD was used as security for financial facility granted. In *Bensa*, the High Court declared that the date of transaction was the time when the FD was charged as collateral to the insurance company, not at the time when it was created. This, I believe is the correct approach. When the FD in this case were created there were no transactions within the meaning of s. 293 of the Companies Act read with s. 53(1) of the Bankruptcy Act. In fact these instruments were not even OAB's; they were the properties of a 3rd party – *Seow Chee Hong* who decided to deposit monies with the bank for safe keeping. It was only when *Seow Chee Hong* pledged these FD to the bank that the transaction occurred. As correctly pointed out by Mr. Christopher Leong, counsel for the bank, one cannot charge one's own indebtedness. Once such transaction had taken place any act subsequent and associated with it must be considered to have arisen out of it. Likewise, the uplifting of the FD was not an independent act but an integral part of the transaction which commenced with the pledging of the FD as collateral with the bank. Consequently, the date for the uplifting of the FD cannot be accepted as the date of the transaction since the transaction had already occurred. The uplifting, being a process under the collateral, in my view, cannot be considered as a transaction within the relevant provisions of the law under discussion. For this I must reject the liquidator's approach that the date of uplifting of the FD was the date of transaction.

Once this time factor is decided attention must be concentrated on when the collateral was created over these FD. From the particulars as set out in p. 25 of the encl. 116 at item 2.7 it is disclosed that these FD were "pledged as security pursuant to letters of offer dated 17 May 1995, 25 October 1995, 6 December 1996 and 19 September 1997". All these dates were outside the twilight period exempting this transaction from scrutiny under the relevant provision of the law.

As a precaution, in the event that I may have erred on this point, I shall proceed to consider other arguments raised by the bank to counter the liquidator's claim for this item.

It is the view of the bank that even if the transaction is considered to be at the time when the FD were uplifted these FD would still be exempted from consideration for undue preference because the bank had a lien over them. Arising from this lien, the bank asserts that it had a Common Law and statutory right (by way of s. 41 of the Bankruptcy Act) to set off this against any sum due by OAB to the bank. To support this assertion, the Federal Court decision of *Sime Diamond Leasing (M) Sdn Bhd v Precision Moulding Industries Sdn Bhd* [1998] 4 CLJ 557 is relied on.

Not willing to concede, the liquidator however argues against the availability of this protection by the bank on two fronts. Firstly, the Common Law right of a lien over the FD was extinguished by the failure to register these FD as charges under s. 108(3)(k) of the Companies Act. Secondly, without this support the Bank's Common Law right of a set-off could not have existed. As to the statutory right of a set-off under s. 41 of the Bankruptcy Act, the liquidator insists that this provision cannot override s. 293 of the Companies Act read with s. 53(1) of the Bankruptcy Act. In short, the liquidator is defiantly asserting that *Sime Diamond Leasing* is incorrectly decided. As an alternative, the liquidator presents that even if s. 41 of the Bankruptcy Act predominates s. 293 of the Companies Act to be read with s. 53(1) of the Bankruptcy Act, there is no evidence to support the existence of "mutual credits and mutual debts or mutual dealings" at the material time between OAB and the bank to qualify the use of this provision.

Whether the FD need to be registered under s. 108(3)(k) of the Companies Act is a point I have already decided in the case of *Bensa (supra)*. As explained, these FD were only evidence of acceptance of deposits of *Seow Chee Hong* by the bank. It was only when they were used as securities that they fell within the category of "a charge on the credit balance of the company in any deposit account" as described in s. 108(3)(k) of the Companies Act. Thus, standing by itself, these FD were not caught under s. 108(3)(k) of the Companies Act but the pledging of these as securities were.

When such collateral were not registered they are void against the liquidator – s. 108(1) of the Companies Act. This statutory enactment must, in my view, override the bank's right to a lien under Common Law over these securities. Consequently, as argued, the Bank's Common Law right to a set-off cannot be maintained for having no basis to rely on.

But what about the bank's statutory right of set-off under s. 41 of the Bankruptcy Act? To examine this prerogative, which is often referred to as 'insolvency set-off', s. 41 of the Bankruptcy Act must first be looked into. It says:

Mutual credit and set-off

(1) Where there had been mutual credits, mutual debts, or other mutual dealings between a debtor against whom a receiving order is made under this Act and any other person proving or claiming to prove a debt under such order, an account shall be taken of what is due from the one party to the other in respect of such mutual dealings, and the sum due from one party shall be set-off against any sum due from the other party, and the balance of the account and no more shall be claimed or paid on either side respectively.

(2) A person shall not be entitled under this section to claim the benefit of any set-off against the property of the debtor in any case where he had at the time of giving credit to the debtor notice of an act of bankruptcy committed by the debtor and available against him?

By virtue of this section when mutual credits and mutual debits or other mutual dealings are apparent insolvency set-off is permitted. But this runs contrary to s. 293 of the Companies Act read with s. 53(1) of the Bankruptcy Act. The Federal Court when encountered with this issue decided in *Sime Diamond Leasing (supra)* to adopt the approach of "where s. 41 of the Bankruptcy Act applies, the payment or agreement for a set-off cannot be construed as a void preference under s. 53 of the Bankruptcy Act."

To support this, Edgar Joseph Jr. FCJ at p. 571 of the same judgment explains:

> Similarly, it is important to note that the case of *Re Washington Diamond Mining Co* [1893] 3 Ch 95 recognises that where s. 41 of the Bankruptcy Act applies, the payment or the agreement for a set-off cannot be construed as a void preference under s. 53 of the Bankruptcy Act. It has been said that in such a situation the fact that the debts would have been set-off in the bankruptcy means that the arrangements have not worked to the detriment of the other creditors of the company. As well put by Vaughan Williams J in *Re Washington Diamond Mining Co* at p. 104, 'You cannot prefer a man … by merely putting him in the very position in which he would be if a bankruptcy followed'.
>
> This case should be compared with *Re BP Fowler Ltd* [1937] 3 All ER 781 where Crossman J held that the payment was a preference notwithstanding that he left open the question whether there would have been a set-off in liquidation, and on this ground his judgment may be regarded as unsatisfactory.

But Mr. Prakash boldly points out that that this ruling is decided per incuriam. It has overlooked the reversal of Vaughan Williams J's decision of first instance by the English Court of Appeal in *Re Washington Diamond Mining Co.* I tend to agree with this view. As stated by Kay LJ in the Court of Appeal in *Re Washington Diamond Mining Co.* at p. 113:

> The first question is as to the meaning and the effect of 164th section (an earlier version of our section 293 of the Companies Act) of the Companies Act, 1862. It is argued that this section only makes that a fraudulent preference which would be so if the company were an individual who has since become a bankrupt, and that in the case of such an individual any of his debtors who had a counter-claim against him which might be set-off in an action may be relieved of such debt by voluntary set-off by the bankrupt before bankruptcy. If this be so, it is by reason of the mutual credit clause, sect. 38 (similar to our section 41 of the Bankruptcy Act) of the Bankruptcy Act, 1883. The effect of that clause is to give the debtor after bankruptcy the advantage of set-off, and therefore, to set-off the debt before the bankruptcy cannot be in any sense fraudulent. But after a winding-up there is no such right of set-off, and, therefore to allow a set-off before a winding-up does confer on the debtor an advantage which may be deem to be fraudulent under sect. 164.
>
> I am unable to read the section as this argument requires us to do. Its object is to prevent a fraudulent preference. If it has the meaning suggested, the case of a voluntary set-off must be an unintentional omission in the statute. But I do not think there is any such omission. I think sect. 164 should be read as meaning that any preference by way of a set-off of a debtor who would have no right of a set-off after winding-up shall be treated in bankruptcy if he had no right to set-off after bankruptcy, and if such a set-off would be a fraudulent preference in bankruptcy it shall be so in a winding-up.

By this it would mean that s. 41 of the Bankruptcy Act does not apply in a situation where s. 293 of the Companies Act read with s. 53(1) of the Bankruptcy Act operates. Taken in the context of our case, this would mean that the bank is not entitled to the set-off as claimed.

To save itself, the bank advanced another argument: that even if the charge instruments were not registered under s. 108(3)(k) of the Companies Act and that the set-off (both the Common Law and statutory type) was not available to bank they are only void against the liquidator at the time when the liquidator was appointed. In this case when the liquidator was appointed the FD had all been up-lifted leaving the liquidator no opportunity to lay his hands on them. To support this, the Singapore Court of Appeal case of *Ng Wei Teck v. OCBC Ltd* [1998] 2 SLR 1 is cited. There the court held that under a similar provision to our s. 108(1) of the Companies Act, the effect of the non-registration of a charge is only void against the liquidator at the time when the liquidator was appointed.

I see no reason why this authority should not be adopted in view of the wordings of our s. 108(1) of the Companies Act is the same as that of the Singapore equivalent. The liquidator in this case was appointed on 11 December 1998. By this time, all the FD had been uplifted leaving nothing for this provision to bite on. Such pledges, I find, are therefore not void against the liquidator.

2. The Sum Of RM55,887.92 FD

These were deposits made by *Seow Chee Hong* with the bank after 4 February 1998 but similar to those FD of the earlier period, were up-lifted in April 1998. By deduction, pledges of these FD as security would have taken place between the time when the monies were deposited with the bank and the uplifting of these FD. This puts the creation of these collateral well within the twilight period and the ambit of s. 293 of the Companies Act to be read with s. 53(1) of the Bankruptcy Act. Applying the same rational as above, these pledges, though not registered under s. 108(3)(k) of the Companies Act, are not void since they were uplifted and spent after the appointment of the liquidator.

(b) Debit Advice

1. A sum of RM8,627,507.93 taken by the bank from OAB's account to repay credit facilities within the period under s. 223.

Record of these payments is in p. 66 of encl. 116 under item 2.2. According to the bank, these were payments made in accordance with the terms of the credit facilities extended to OAB for settlement of trade bills, trust receipts and foreign bills of exchange utilised by OAB in its ordinary course of business. These were *bona fide* transactions and the bank possessed no knowledge of any impropriety.

Since these dispositions were after the presentation of the winding-up petition s. 223 of the Companies Act applies. *Prima facie*, these payments are void to prevent improper alienation and dissipation of the property of the company *in extremis* but "when a company actually trading, which is the interest of every one to preserve, and ultimately to sell, as a going concern, is made the object of a winding-up petition, which may fail or may succeed, if it were to be supposed that transactions in the ordinary course of its current trade, *bona fide* entered into and completed, would be avoided, and would not, in the discretion given to the court, be maintained, the result would be that the presentation of a petition, groundless or well-founded, would, *ipso facto*, paralyse the trade of the company, and great injury, without the counterbalance of advantage, would be done to those interested in the assets of the company" – per Lord Cairns LJ in *re Wiltshire Iron Company* [1868] LR 3 Ch 443 at 447.

In more recent times, the courts in England have expressed harshness of this provision and recommended some form of relaxation in its approach. This can be seen from the judgment of Phillimore LJ in *Re Clifton Place Garage Ltd* [1970] 1 All ER 353 at 359:

> This is a very harsh section as applied. We were told that the first result of a petition seeking an order for winding-up of a company by the court is that its bank refuses to honour its cheques, although it will continue to accept receipts in its favour. It follows that, even in a case of a company where the court ultimately refuses the order, serious damage may have resulted from the petition. After all, one of the results of the petition and of such action of the bank is that the company may have great difficulty in paying its employees, and, if it does pay them, the payments if derived from the funds of the company are *prima facie* void. All these dates from 'the good old days' where landlord and creditors came before anyone else. I am not suggesting that they should come after anyone else; but in my judgment the court should extend indulgence to any disposition by a company honestly designed to ensure that its employees are paid their wages or which was made to enable it to carry on its business and perhaps 'turn the corner'; provided always that it was a reasonable disposition and not dishonest or reckless.

Though accepting these principles enunciated are correct, the liquidator argues that the bank has not provided any proof that these debit advice were for the continuation of OAB's business and that the bank had acted in good faith. Further, there were no advantages enjoyed by OAB or its creditors on these dispositions. On the last factor the case of *Hamilton v. National Australia Bank Ltd* [1991] 5 ACSR 432 is cited where McLelland J in the Supreme Court of New South Wales, Australia declares at 434:

> the essential question for determination is to ascertain whether overall the relevant transaction could at the time reasonably be perceived as offering some advantage, or at least potential advantage, to the company and thereby its general body of creditors. It is necessary to weigh the benefits supposed to flow to the company from the transaction against the detriment to be suffered by the general body of creditors in consequence of the transaction.

Bearing in mind the above propositions, I shall now proceed to analyse the facts of this case. These dispositions arose from the bank's consent to continue to finance OAB after Arthur Anderson's reports on the financial viability of OAB and a subsequent meeting between Arthur Anderson, OAB and the bank. As a result of this decision, OAB was allowed to draw on credit to finance OAB's exports against trade bills, trust receipts and foreign exchange bills. And when these instruments matured monies generated therefrom were debited to the bank. This replenishment allowed OAB to operate within its credit limit for its next and subsequent line of export. This was the nature and characteristic of this type of facility. When dispositions were made to the bank generated from this type of arrangement I cannot see how undue preference could have been practiced. These dispositions were part and parcel of a facility that benefited OAB directly and its creditors generally. It allowed OAB an opportunity to continue to trade in an attempt to 'turn the corner' so to speak.

In addition, I do not believe that the bank had acted dishonestly in accepting these dispositions or when extending such credit facility to OAB. And neither do I consider the bank reckless in arriving at such a decision. As disclosed, this decision was only resolved after the evaluation of Arthur Anderson's report which gave an optimistic view on the financial health of OAB. Besides there was also a conference between the bank, Arthur Anderson and OAB before the bank decided to go ahead to continue with the assistance to OAB. This summarises the bank's prudence in its action. It must be accepted that all commercial decisions come with risk and when outcome do not match the forecast, as was the case here, the bank cannot be taken to task for the decision it made when such decision was not dishonest or reckless. On these grounds, I am satisfied that the bank has rebutted the presumption that these dispositions were void under s. 223 of the Companies Act.

2. A Sum Of RM20,018,429.30 Taken During The Twilight Period By The Bank From OAB Account To Repay Towards Credit Facilities

These debit advice, according to the bank, were debited from OAB's account on the same arrangement as those above (concerning the sum of RM8,627,508.93), except that these were carried out earlier. The bank added that these payments were part of a wider transaction and were conducted under a running account.

The liquidator, on the hand, raised the same issue of whether the bank was *bona fide* in carrying out these dispositions and insists that OAB was, at this period, hopelessly insolvent making these payments preferential treatment over other creditors.

Undisputedly this item falls within s. 293 of the Companies Act to be read with s. 53(1) of the Bankruptcy Act for consideration. To reiterate, the design of this provision is to preserve the sanctity of the *pari passu* principle by which creditors in a winding-up share rateably in the asset available for distribution. But in order for the liquidator to succeed he must satisfy five conditions – see *Sime Diamond Leasing (supra)* and *Bensa (supra).* These are:

1. that the transaction in question took place within six months prior to the commencement of the winding-up;
2. that it is the type of transaction mentioned in s. 53(1) of the Bankruptcy Act;
3. that it took place at a time when the company was insolvent;
4. that the person in whose favour the transaction was effected stood in the relation of a creditor to the company;

5. that the effect of the transaction was to confer on that person a preference, priority or advantage over other creditors in the winding-up.

The onus of proving whether all these conditions are complied with is on the liquidator, not the creditor – *Sime Diamond Leasing (supra).*

From the submissions of the parties, I gather that only conditions 3 and 5 are questioned. The others, not being commended on, must be considered as satisfied. In any event from the facts presented, I am of the view that they are fulfilled.

Commencing with the insolvency factor, I shall first turn to the Australian High Court case of *Sandell v. Porter* [1966] 115 CLR 666 for assistance. At p. 670 of the judgment the definition of insolvency is described in the following manner:

> The conclusion of insolvency ought to be clear from a consideration of the debtor's financial position in its entirety and generally speaking ought not to be drawn simply from evidence of a temporarily lack of liquidity. It is the debtor's inability, utilising such cash resources as he has or can command through the use of his assets, to meet his debts as they fall due which indicates insolvency. Whether that state of affairs has arrived is a question for the Court and not one as to which expert evidence may be given in terms though no doubt experts may speak as to the likelihood of any of the debtor's assets or capacities yielding ready cash in sufficient time to meet the debts as they fall due.

Now turning to the evidence I note that undoubtedly OAB was facing liquidity problem during this period. But from the outlook projected by Arthur Anderson this could be temporary. Its reports say "the short term viability review of the Group indicates that OAB has a viable core business with a net profit before tax exceeding RM16 million before finance charges with a surplus cash flow position expected to be generated over the next twelve months". Perusing further into Arthur Anderson's investigation I am of the view that against the liabilities of OAB with its assets and secured contracts, OAB was not insolvent though under enormous financial constrain. I have been reminded in the judgment of *Sandell v. Porter* that the interpretation of insolvency of a company should not be left to the experts but in this case, I do not think it is unwise to rely on Arthur Anderson's assessment since this firm of financial consultant had the opportunity to examine and study all the relevant documents and books of accounts of OAB in the course of its evaluation of OAB's financial position at the material time. Who else would be in a better position? Further, I find no challenge mounted by the liquidator to indicate that these reports of Arthur Anderson were in any way bias or inaccurate.

The next factor to be considered is whether this transaction was a conferment of preference, priority or advantage on the bank over other creditors of OAB.

As pointed out in Australian High Court case of *Airservices v. Ferrier* 21 ACSR 1 at 14:

> For the purpose of s. 122 (similar to our section 53 of the Bankruptcy Act), the effect of a payment on the other creditors of the debtor is determined objectively. If the payment has the effect of giving a creditor a preference over other creditors, it does not matter that neither the creditor nor the debtor intended to give the creditor preferential treatment. As Starke J pointed out in *S Richard & Co Ltd v. Lloyd* [1933] 49 at 62 the section "looks to the effect of the transaction and not to the intent, or state of mind, of the debtor". But that does not mean that the purpose of the debtor in making a payment has no evidentiary significance.
>
> If a payment is a part of a wider transaction or a "running account" between the debtor and the creditor, the purpose for which the payment was made and received will usually determine whether the payment has the effect of giving the creditor a preference, priority or advantage over other creditors.

In this case of *Airservices Australia v. Ferrier* a commercial airline company went into liquidation. In the six months prior to winding-up, this airline company had made payments to the Civil Aviation Authority where the company operated its aircraft. Such payoffs, the liquidator of the company claimed, were undue preferential payments. The court, by majority, ruled that there was no undue preference and stated at p. 19 of the judgment that the:

> account was an active one with daily dealings between the parties. Services rendered during the preceding month were debited to the account at the beginning of each month. In addition, penalties for late payment were debited monthly. The balance of the account rose and fell as debits and credits were recorded. There was but one account, not a series of separate accounts for each month or for each service ...

The factual matrix of our case is very similar to that of *Airservices*. There was a running account with credits and debits recorded. When OAB required to export its manufactured goods it used the trade facilities granted by the bank and when these trade bills, trust receipts and foreign exchange bills matured they were credited into OAB's account. The entire purpose of the operation was to sustain the business activity of OAB at that relevant time. I do not think that the debit advice transacted during this period have the effect, as well as, the purpose of giving undue preference to the bank. They were, as stated earlier, a normal financial business transaction to cater for a company engaged in international trade.

(c) Trade Bill & OD Charges

1. RM49,537.99 And RM9,299.41 Respectively Incurred During The Period Under Section 223 Of The Companies Act

These were charges by the bank for credit facilities granted to OAB to continue with its business. The laws applicable on this subject are the same as those discussed above under para. (b) 1 of "Debit Advice". There is no necessity for me to repeat them. As for its application to the facts I find that the bank has proved to the satisfaction of this court that these dispositions were not undue preference.

2. RM1,695.56 And RM139,849.85 Respectively Incurred During The Twilight Period

Again these were charges incurred in the use of the credit facilities granted by the bank to OAB for their business activity. The laws are once again that applicable to those discussed under para. (b) 2 of "Debit Advice" warranting no necessity to go over them again. Similarly, applying the tests as set out to the facts of this claim, I find that conditions 3 and 5, which are required to be fulfilled in order for s. 293 of the Companies Act to be read with s. 53(1) of the Bankruptcy Act to succeed, have not been satisfied by the liquidator. The claim for this item must therefore fail.

(d) Security Documents

1. Loan Agreement; 2. Debenture; 3. Account Assignment Agreement; 4. Supplementary Loan Agreement; all made within the twilight period

Arising from these security documents were some of the dispositions considered by this court earlier. Once again for the purpose of determining whether these were undue preference under s. 293 of the Companies Act read with s. 53(1) of the Bankruptcy Act the five conditions as set out earlier (under para. (b) 2 of "Debit Advice") must be satisfied. To reiterate, this court is of the view that at the material time when these instruments were created OAB was not insolvent. OAB, as discussed earlier, was facing liquidity problems but not insolvent within the concept as laid down in *Sandell v. Porter (supra).* As the undue preference factor, from facts presented, I find no trace of *mala fide* on the part of the bank to secure these instruments other than to assist OAB to have an opportunity to regain its business strength. The creation of these instruments was part of this exercise as well as of a wider transaction that began way back in 1995. For the facilities to be made available it was not uncharacteristic of the bank to obtain securities. This was in accordance with normal ordinary banking practices. I am not convinced that these were carried out to give undue preference to the bank.

2. The Second Supplementary Loan Agreement Created Under Section 223

Again the law as regards to s. 223 of the Companies Act has been spelled out earlier. But I hasten to add that the approach adopted in *Re Gray Inns Construction Co Ltd* (1980), where banks should freeze the accounts or seize the monies of their customers facing a winding-up petition, is no longer encouraged. In fact the English Court of Appeal in *Re Clifton Place Garages Ltd* has commented that such practices are very hash. Finally in *Hollicourt (Contracts) Ltd v. Bank of Iceland* [2001] 1 All ER 281 the same Court decided that this recommendation in *Re Gray Inns Construction Co Ltd* is no longer applicable. Presently, a company faced with a winding-up petition should be encouraged to continue business in the ordinary way, and the court should extend indulgence to any dispositions made for payment of wages to the staff and those that enable the company to carry on its business provided they are "reasonable disposition(s) and not dishonest or reckless" – *Re Clifton Place Garage Ltd (supra).* Based on these and the similar reasons expressed earlier on other items under contention for this same period, I find the liquidator's claim to declare this disposition void and for the return of such monies unsustainable.

Non-compliance Of With Internal Procedures Of OAB

There is an allegation by the liquidator against the bank which is out of the main stream of undue preferential dispositions under s. 293 of the Companies Act read with s. 53(1) of the Bankruptcy Act, and s. 223 of the Companies Act. This relates to the security documents which the liquidator claims is void for being irregular by the absence of resolutions passed by OAB in the creation of these instruments and insufficient quorum of directors to transact them.

All these, I think, can be dismissed under the Turquand rule as adopted into our Malaysian law through the case of *Pekan Nanas Industries Sdn Bhd v Chang Ching Chuan & Ors* [1998] 1 CLJ 793. The liquidator has not rebutted the presumption that an outsider is not affected by the irregularity of the company. Further, the bank, who benefited from these transactions, had waived these irregularities to allow the stipulations in these documents to continue as they were – see the case of *Tan Ah Chim & Sons Sdn Bhd v. Ooi Bee Tat & Anor* [1993] 4 CLJ 476. And finally, under s. 20 of the Companies Act no act or purported act of a company (including entering into an agreement) and no conveyance or transfer of property to or by the company shall be invalid by reason only of the fact that the company was without capacity or power to do the act or to execute or take the conveyance or transfer.

Conclusion

Based on the above, I hereby dismiss the liquidator's requests in encl. 110 with cost.